COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, NOVEMBER 1, 2002

APPLICATION OF

VIRGINIA ELECTRIC AND POWER COMPANY CASE NO. PUE-2001-00664

To revise its cogeneration tariff pursuant
to PURPA Section 210

FINAL ORDER

The matter before the Commission concerns the March 18, 2002, application of Virginia Electric and Power Company ("Virginia Power" or "Company") to change its cogeneration and small power production payments under Schedule 19. As set forth in that application, the proposed Schedule 19 utilizes market-based pricing rather than administratively-determined avoided costs to determine the Company's payments to qualifying facilities for energy purchased under the Public Utility Regulatory Policies Act of 1978 ("PURPA"). Virginia Power further proposes that Schedule 19, if and as revised, remain in effect for 2002 and 2003.

By order entered on June 13, 2002, the Commission scheduled a September 5, 2002, hearing concerning the application, established a procedural schedule for filing testimony and evidence, and appointed a Hearing Examiner to hear the case. Appalachian Power Company, d/b/a American Electric Power; Michigan Cogeneration Systems, Inc. d/b/a/ Landfill Energy Systems; Scott Wood, Inc.; and Tractebel North America filed timely Notices of Participation in this case, all of which were subsequently withdrawn by these parties.

On September 5, 2002, the evidentiary hearing was convened before Michael D. Thomas, the Hearing Examiner assigned to this matter. Donald G. Owens, Esquire, and Jill C. Hayek, Esquire, appeared on behalf of Virginia Power. Arlen K. Bolstad, Esquire, appeared on behalf of the Staff. No public witnesses appeared at the hearing.

Virginia Power emphasized in its application and at the hearing, that the energy markets are making their transition to competition. The enactment of the Virginia Electric Utility Restructuring Act[1] evidences the intent of Virginia's legislature that Virginia's retail markets join in that movement. Of course, in this proceeding the matter before the Commission is the matter of wholesale payments Virginia Power will make to cogeneration facilities and small power producers.

Under PURPA, this Commission (as well as other states commissions) is authorized to establish utility payments to PURPA-qualified cogeneration facilities and small power producers ("qualifying facilities" or "QFs") on the basis of costs avoided by Virginia Power by obtaining power from these QFs rather than acquiring such power from other sources. Significantly, in this proceeding Virginia Power proposes to change the methodology it presently uses to calculate payments to its QFs under Schedule 19. The proposed Schedule 19 utilizes market-based pricing to determine the Company's avoided costs, rather than the traditional differential revenue requirement ("DRR") methodology.

As outlined by Hearing Examiner Thomas in his report, Virginia Power raises three primary arguments in support of its application for market-based pricing. First, the Company contends, market-based pricing is appropriate since the energy market in Virginia is changing from a monopoly-based market to a competitive market where customers can purchase energy from a variety of providers.[2] Second, the Company's forecast for the period 2002 through 2007 shows that it will meet much of its future energy needs through purchases in the marketplace. Finally, wholesale markets have matured to the point where they can be used to determine the wholesale cost of electricity in Virginia.

Accordingly, Virginia Power proposes to offer QFs the following two options: (i) new QFs and existing QFs whose contracts stipulate payments under Schedule 19, will be paid the

[1] Chapter 23 (§ 56-576 et seq.) of Title 56 of the Code of Virginia.

[2] This view reflects Virginia's 1999 enactment of the Restructuring Act. Additionally, the efforts by the Federal Energy Regulatory Commission to create broader, more efficient wholesale energy markets, have contributed to this perception as well.

market-based rates contained in the proposed Schedule 19, or (ii) QFs whose contracts stipulate payments based on components of the DRR model may elect to either: (a) receive the market-based rates contained in the proposed Schedule 19; or (b) continue to receive payments estimated using components of the existing DRR methodology during the 2002 – 2003 period.

The QFs that fall within Option (i) above are: Alexandria/Arlington MSW Facility; Kirk Lumber; Merck Facility; Rivanna Water & Sewer; Southeastern Public Service Authority; and Brasfield Dam (only non-firm energy rate portion of the contract). The QFs that fall under Option (ii) above are: Stone Container Corporation; I-95 Landfill; I-95 II; Richmond Electric Corporation; and Suffolk Landfill.

As noted by the Hearing Examiner, Virginia Power proposes adopting the market price methodology used by this Commission in its 2001 proceeding to determine wires charges for retail customers selecting competitive suppliers for generation services.[3] In that case, the PJM West and Cinergy markets were used to determine the market prices that are central to calculating these wires charges. Virginia Power believes the same methodology would be appropriate for Schedule 19. The Company also proposes that the market price data for 2003 calculated in the Commission's 2002 wires charge proceeding, be used to determine Virginia Power's Schedule 19 market-based prices for 2003.

The methodology used in the 2001 wires charge case produced on-peak and off-peak market rates for 2002 along with a charge for transmission and ancillary service. Virginia Power added the transmission and ancillary service charge to the average of the PJM West and Cinergy annual prices to calculate its on-peak energy price of 3.454¢/kWh and off-peak energy price of 2.044¢/kWh. These prices are subject to a line loss percentage adder. In contrast, the DRR methodology results in an on-peak rate of 3.067¢/kWh and an off-peak rate of 2.303¢/kWh.

The Staff's only concern with the Company's proposed Schedule 19 related to the term of contract language found in Section VII. It appeared to the Staff that the Company would not

[3] *Ex Parte: In the matter of considering requirements relating to wires charges pursuant to the Virginia Electric Utility Restructuring Act*, Case No. PUE-2001-00306 (Order, November 19, 2001).

enter into a contract of less than one year. To address the Staff's concern, the Company amended the language in that Section to make it clear that the term of the contract would be as mutually agreed upon by the parties, but in no event would it extend beyond December 31, 2003. With that change, the Staff recommends that the Commission approve Virginia Power's proposed Schedule 19, as revised.

Hearing Examiner Thomas concluded that the methodology employed by Virginia Power to calculate its market rates for purchases of electricity from QFs appears reasonable. Moreover, he noted that the market-based rates that were derived are generally more favorable to the QFs than the DRR-derived rates.

NOW THE COMMISSION, in consideration of the record developed in this matter, and upon review of the September 10, 2002, report prepared by Hearing Examiner Michael Thomas, finds that the methodology proposed by Virginia Power to derive its Schedule 19 energy purchase prices for 2002 is reasonable. We further agree with the Hearing Examiner that such methodology may be reasonably employed by the Company to update 2003 energy purchase prices, utilizing market price data developed in the Commission's 2002 wires charge proceeding.

Accordingly, IT IS ORDERED THAT:

(1) The recommendations set forth in the Hearing Examiner's September 10, 2002, report are hereby adopted and approved;

(2) The Company may utilize the methodology proposed in its application to determine its Schedule 19 energy purchase prices for 2002 and 2003 as set forth in this Order;

(3) The Company's proposed revisions to Section VII of Schedule 19 clarifying the length of contracts are also approved; and

(4) This matter is dismissed from the Commission's docket of active cases, and the papers herein are passed to the file for ended causes.